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THE LITTLE BOOK OF STOCK MARKET CYCLES

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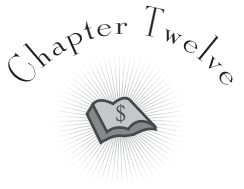

Celebrate Good Times

Making the Most of Holiday Trading

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EVERYONE NEEDS A BREAK now and then, even the markets and market-followers. The New York Stock Exchange (NYSE) closes nine times throughout the calendar year to celebrate select holidays, including New Year's Day, Martin Luther King Jr. Day, Presidents' Day, Good Friday, Memorial Day, Independence Day, Labor Day, Thanksgiving Day, and Christmas.

Obviously there are many other holidays and special occasions that people observe while the market remains

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open. But never fear. In the age of the smart phone, traders and investors can still access market data and make trades. Just don't let your mother catch you sneaking away to review and trade your investments. Although trading might be distracted during these times, most non-observed (by the NYSE) holidays have little discernable impact on the overall market. The exceptions are the Jewish High Holidays of Rosh Hashanah, Yom Kippur, and Passover—these exhibit influence on the markets, which we'll discuss later in the chapter.

Santa Claus Comes to Town

You might think we'd start by talking about the New Year holiday, but it's actually best to begin with the last holiday of the previous year, Christmas. Thanks to the Santa Claus Rally (the seven-trading-day period beginning after Christmas) the days before and after Christmas and New Year's Day are best for trading, especially tech stocks and small caps. NASDAQ and the Russell 2000 have averaged gains of 3.1 percent and 2.4 percent from three days before Christmas to three days after New Year's Day since 1990.

Gains can be contributed to year-end holiday spirit, year-end bonus payments, and the end of tax-loss selling. It doesn't hurt that these holidays fall in the Best Six Months of the year and right in the middle of the best consecutive three-month span.

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Table 12.1 Trading Before and After Christmas Day Observances (since 1990)

	Day Before			Day After		
	# Advance	# Decline	Average %	# Advance	# Decline	Average %
DJIA	14	8	0.28	16	6	0.24
S&P 500	14	8	0.26	16	6	0.22
NASDAQ	14	8	0.51	17	5	0.25
Russell 2000	16	6	0.40	18	4	0.37

We regularly examine market action three days before and after a NYSE holiday, but the getaway day before and the day after are impacted most by the holiday. The market consistently revels the day before and after Christmas. Table 12.1 shows traders holiday shopping for stocks at Christmastime. I have gone back to 1990 for a better perspective of trading in recent years during both secular bull and bear markets.

Less bullishness on the last day is due to last-minute portfolio restructuring. Pushing gains and losses into the next tax year often affects the new year's first trading day. Recently this selling pressure has continued into the new year. This selling is evident by the negative average percent change for the Dow and S&P 500. And although the NASDAQ and Russell 2000 appear less negative, the NASDAQ has been down 10 of the last 11

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Table 12.2 Trading Before and After New Year's Day Observances (since 1990)

	Day Before			Day After		
	# Advance	# Decline	Average %	# Advance	# Decline	Average %
DJIA	10	12	–0.23	15	7	0.40
S&P 500	8	14	–0.21	10	12	0.27
NASDAQ	12	10	0.04	14	8	0.22
Russell 2000	13	9	0.35	8	14	–0.14

last trading days of the year after rising for 29 straight years from 1971 to 1999. Russell 2000 has been down 9 of the last 11 years on the last day after 21 consecutive years of gains from 1979 to 1999. (See Table 12.2.)

Martin Luther King Jr. Day

Significant fourth-quarter rallies have a tendency to correct or consolidate in January. Over the years this trend has begun at different times in January. For example, in 2008 it started on day one, but in 2010, it began mid-month. Regardless of the actual starting point, mid-month January weakness has had a negative impact on the most recent holiday to be formally observed by the NYSE, Martin Luther King Jr. Day.

Recognition and observance of one of history's most important civil rights leaders on the third Monday of January every year since 1998 can delay the start of option's

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Table 12.3 Trading around Martin Luther King Jr. Day Observance (since 1998)

	Day Before			Day After		
	# Advance	# Decline	Average %	# Advance	# Decline	Average %
DJIA	8	6	0.19	7	7	–0.33
S&P 500	9	5	0.25	7	7	–0.31
NASDAQ	9	5	0.26	7	7	–0.24
Russell 2000	10	4	0.23	7	7	–0.11

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expiration week. A shortened trading week could also partly be responsible for the market's poor performance on Tuesday and frequently even worse trading action later in the week. Establishing a short position, into strength on the Friday before this three-day weekend, has the best odds of a profitable outcome in the following week. (See Table 12.3.)

Negative Presidents' Day

Presidents' Day is the lone holiday that exhibits weakness the day before and after. Trading has turned more negative over the last 22 years. The Friday before this mid-winter three-day break is exceptionally bad, whereas the Tuesday after is not as brutal and has shown some improvement recently although average losses are greater for NASDAQ and the Russell 2000. (See Table 12.4.)

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Table 12.4 Trading around Presidents' Day Observance (since 1990)

	Day Before			Day After		
	# Advance	# Decline	Average %	# Advance	# Decline	Average %
DJIA	6	16	–0.34	10	12	–0.33
S&P 500	5	17	–0.47	11	11	–0.44
NASDAQ	5	17	–0.68	6	16	–0.88
Russell 2000	10	12	–0.27	7	15	–0.64

Two unusually strong market showings in 1991 and 2003 were both related to military action in the Persian Gulf. In 1991 the month-long punishing air war waged by coalition forces to liberate Kuwait from Saddam Hussein's August 1990 invasion began to impact Iraqi forces. On February 15, 1991, the Friday before Presidents' Day, Iraq's offer to pull out of Kuwait for the first time tied to lifting sanctions was rejected by President Bush as a "cruel hoax." The following Tuesday after the holiday, General Schwarzkopf said Iraqi forces were "on the verge of collapse." These two clear signs of capitulation were celebrated on Wall Street with buying. In February 2003 the Dow had dropped 13.2 percent from the previous November high as the anticipation of another fray into Iraq loomed over the world. As the invasion of Iraq became imminent the market rallied the day before and after Presidents' Day before falling to its final 2003 low the week before the March 19 offensive.

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Leading up to the Friday before Presidents' Day the market is quite strong three days before the holiday weekend. You can use this strength to lock in profits before you leave for the slopes or the islands. If you plan to stick around and trade, consider setting up a short trade to capitalize on market weakness that often plagues this time of year. Friday has the most consistent record of declines, but those losses do not frequently carry over into Tuesday, making Friday the best day to cover any short positions. Hopefully you will enjoy presidential profits around this brief mid-winter holiday.

The Luck of the Irish

Saint Patrick's Day is the only recurring holiday in March. Sure, Good Friday and Easter land in March from time to time, but it's only happened 12 times in the past 62 years. Saint Patrick's Day, however, occurs on the same day every year. Although there is no official stock market closing or bank holiday it is celebrated by millions (perhaps billions) of people every year. And the festivities do hit close to Wall Street. Parades are held worldwide, but the largest runs right up the center of Manhattan. New York City has hosted an annual parade since 1762.

Gains on Saint Patrick's Day or the day after when it falls on the weekend have been greater and much more consistent than the day before. Anticipation of the patron

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Table 12.5 Trading around St. Patrick's Day (since 1990)

	Day Before			March 17 or the Day After*		
	# Advance	# Decline	Average %	# Advance	# Decline	Average %
DJIA	12	10	0.22	16	6	0.62
S&P 500	14	8	0.18	17	5	0.66
NASDAQ	11	11	–0.11	15	7	0.71
Russell 2000	9	13	–0.19	16	6	0.61

*Either March 17 or the following trading day when St. Patrick's Day falls on a weekend.

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saint's holiday and preparations for the parade down Fifth Avenue may cause equity markets to languish. Perhaps the absence of those participating in the festivities drives the snakes out of Wall Street, leaving only the strongest professional hands to gather up the gold at the end of the rainbow. Or maybe it's the fact that Saint Pat's usually falls in Triple-Witching Week. Table 12.5 illustrates that since 1990 the market is weaker before Saint Patrick's Day, but only suffered a handful of losses the day of or after.

A "Better" Good Friday

Good Friday is the one NYSE holiday with a clear positive bias before and negativity the day after. NASDAQ is up 15 of the last 17 days before Good Friday and 11 straight since 2001. The day after Easter has the second

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Table 12.6 Trading around Good Friday Observance (since 1990)

	Day Before			Day After		
	# Advance	# Decline	Average %	# Advance	# Decline	Average %
DJIA	15	7	0.48	11	11	–0.08
S&P 500	15	7	0.53	9	13	–0.13
NASDAQ	16	6	0.58	11	11	–0.29
Russell 2000	16	6	0.61	6	16	–0.21

worst post-holiday record; losses are steeper after Presidents' Day. The S&P 500 was down 16 of 20 years on the day after Easter, but it has been up 6 of the last 8 years. Table 12.6 shows a strong market before Good Friday and weakness after.

When Good Friday falls in April, the day before is more positive than when it lands in March. The S&P 500 is up 9 of the last 11 times the holiday fell in April. The day after Easter is still negative when the holiday falls in April, though less so than when it occurs in March. This is likely related to March's end-of-quarter volatility and the overall bullishness of April, the best Dow month of the year.

Memorial Day and the Stock Market

Congress voted to recognize Memorial Day at the end May with the National Holiday Act of 1971. Since

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Table 12.7 Trading around Memorial Day Observance (since 1990)

	Day Before			Day After		
	# Advance	# Decline	Average %	# Advance	# Decline	Average %
DJIA	11	11	–0.17	15	7	0.27
S&P 500	11	11	–0.10	11	11	0.20
NASDAQ	11	11	–0.08	12	10	0.32
Russell 2000	12	10	–0.01	11	11	0.29

1971, Memorial Day has been observed on the last Monday in May. Memorial Day has had a weak bias ahead of the long weekend and strength after the holiday. Early departures for the first long summer weekend have driven the Dow down in three of the last four years.

The week after Memorial Day has been sporadic, following the short-term trend of the market. The Dow Jones Industrials was up 12 years in a row from 1984 to 1995. The last 16 years it has been up 7 times with some substantial, triple-digit gains in 1999, 2000, 2003, and 2007 to 2009. However, in the past two years there have been substantial declines: 204.66 in 2010 and 290.32 in 2011 (see Table 12.7).

Few Fireworks on Independence Day

Trading on the day before and after the Independence Day holiday is often lackluster. Volume tends to decline on either side of the holiday as vacations begin early and

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Table 12.8 Trading around Independence Day Observance (since 1990)

	Day Before			Day After		
	# Advance	# Decline	Average %	# Advance	# Decline	Average %
DJIA	12	10	0.03	9	13	0.03
S&P 500	12	10	0.03	11	11	–0.07
NASDAQ	11	11	–0.06	9	13	–0.09
Russell 2000	11	11	–0.18	9	13	–0.16

finish late. Although improving modestly in recent years, since 1980, DJIA, S&P 500, NASDAQ, and Russell 2000 have recorded average losses on the day before and the day after. The same summertime vacation theme consisting of early departures and late returns is the most likely culprit. (See Table 12.8.)

Trading the Labor Day Markets

For many people, Labor Day weekend is the prime vacation time. Back in the first half of the twentieth century approximately one-fourth of the country worked on farms as compared with less than 2 percent nowadays. Business activity ahead of the long weekend was more energetic in the old days. From 1950 through 1977 the three days before Labor Day pushed the Dow Jones Industrials higher in 25 of 28 years. Since then bullishness has shifted to the last day before and the two days after. This frequently

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Table 12.9 Trading around Labor Day Observance (since 1990)

	Day Before			Day After		
	# Advance	# Decline	Average %	# Advance	# Decline	Average %
DJIA	11	11	0.09	13	9	0.26
S&P 500	11	11	0.09	12	10	0.25
NASDAQ	12	10	0.15	12	10	0.16
Russell 2000	15	7	0.10	10	12	0.22

coincides with early September strength. While positive across-the-board gains on the day before and after are prevalent since 1990, the frequency of these gains is only slightly better than half the time. The small caps of the Russell 2000 have the most consistent record of gains on the day before. (See Table 12.9.)

Sell Rosh Hashanah, Buy Yom Kippur, Sell Passover

There is an old saying on Wall Street, "Buy Rosh Hashanah, Sell Yom Kippur." Though it had a good record at one time, it stopped working in the middle of the last century. Still, it gets tossed around every autumn when the High Holidays are on the minds of traders as many Jewish colleagues take off to observe the Jewish New Year and Day of Atonement. But we have observed that the wiser course of action has been to Sell Rosh

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Hashanah, Buy Yom Kippur, Sell Passover. The basis for the new pattern is that with many traders and investors busy with religious observance and family, positions are closed out and volume fades creating a buying vacuum. (See Table 12.10 for the details.)

When the holiday falls on a weekend the prior market close is used. It's no coincidence that Rosh Hashanah and Yom Kippur fall in September or October, two dangerous and opportune months. Passover conveniently occurs in March or April, right near the end of our Best Six Months Switching Strategy.

Perhaps it's Talmudic wisdom but selling stocks before the eight-day span of the High Holidays has avoided many declines, especially during uncertain times like 2008. Being long Yom Kippur to Passover has produced more than twice as many advances, averaging gains of 6.7 percent. This trade worked particularly well in 2009, 2010 and 2011. It often pays to be a contrarian when old bromides are tossed around, buying instead of selling Yom Kippur.

Trading the Thanksgiving Market

For 35 years the combination of the Wednesday before Thanksgiving and the Friday after had a great track record, except for two occasions. Attributing this phenomenon to the warm holiday spirit was a no-brainer. But publishing it in the *1987 Stock Trader's Almanac* was the

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Table 12.10 Sell Rosh Hashanah, Buy Yom Kippur, Sell Passover

	Rosh Hashanah to Yom Kippur Dow % Change	Yom Kippur to Passover Dow % Change
1971	–2.7	6.4
1972	–1.7	0.9
1973	2.3	–12.7
1974	–0.3	20.7
1975	–3.9	22.1
1976	–3.1	–5.2
1977	–1.8	–3.2
1978	4.1	–3.4
1979	–2.3	–10.1
1980	2.7	4.3
1981	4.2	–4.0
1982	0.4	22.8
1983	–1.5	–5.0
1984	–2.4	6.5
1985	0.3	39.6
1986	1.4	25.3
1987	2.1	–24.7
1988	1.0	13.7
1989	3.7	–2.2
1990	–4.1	18.8
1991	0.2	11.6
1992	–3.0	7.1
1993	–2.5	6.5
1994	1.8	6.4
1995	–0.5	19.9
1996	1.0	15.9
1997	0.4	11.8
1998	0.7	25.4
1999	–1.9	0.2
2000	–0.8	–7.4
2001	–2.7	19.8
2002	–0.6	–0.5

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Table 12.10 (*Continued*)

	Rosh Hashanah to Yom Kippur Dow % Change	Yom Kippur to Passover Dow % Change
2003	3.0	10.2
2004	–1.8	1.1
2005	–3.0	9.0
2006	1.4	7.2
2007	2.9	–7.0
2008	–20.9	–5.8
2009	–0.3	11.4
2010	1.8	15.6
2011	–0.5	17.6
Average	**–0.7**	**7.0**
# Up	**18**	**28**
# Down	**23**	**13**

kiss of death. Wednesday, Friday, and Monday were all crushed, down 6.6 percent over the three days in 1987. Since 1988 Wednesday to Friday gained 14 of 24 times with a total Dow point gain of 451.20 versus Monday's total Dow point loss of 619.07, down 9 of 13 since 1998.

Roles were reversed in 2011. Wednesday and Friday got slammed 263 Dow points and bounced 291 points the following Monday. European debt concerns, signs of slowing growth in China, and another budget deal failure in Washington, D.C., caused the worst Thanksgiving week since 1932 and the third worst loss since 1901. But a 16.4 percent increase in holiday shopping over the weekend and news that European leaders were advancing

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Table 12.11 Trading around Thanksgiving Day Observance (since 1990)

	Day Before			Day After		
	# Advance	# Decline	Average %	# Advance	# Decline	Average %
DJIA	14	8	0.17	13	9	0.13
S&P 500	14	8	0.22	13	9	0.17
NASDAQ	16	6	0.39	16	6	0.49
Russell 2000	15	7	0.36	17	5	0.30

a plan to deal with the region's debt crisis resulted in market advances across the board on Monday.

Dubai's debt crisis cancelled Black Friday on Wall Street in 2009; DJIA shed 154.48 in the day's shortened trading session. All four indexes have declined on the day after Thanksgiving the past three years. The best strategy seems to be going long into weakness Tuesday or Wednesday and staying in through the following Monday or exiting into strength prior. (See Table 12.11.)

At a Glance

- Thanks to the Santa Claus Rally, the days before and after Christmas and New Year's Day are best. However, trading around the first day of the year has been mixed. Traders recently have been selling more the first trading day of the new year.

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- Bullishness before Labor Day and after Memorial Day is affected by strength the first day of September and June. The second worst day after a holiday is the day after Easter. Surprisingly, the following day is one of the best second days after a holiday, right up there with the second day after New Year's Day.
- Presidents' Day is the least bullish of all the holidays—bearish the day before and three days after. NASDAQ has dropped 17 of the last 22 days before Presidents' Day (Dow, 16 of 22; S&P, 17 of 22; Russell 2000, 12 of 22).
- Like the other recurring stock market cycles there is an ebb and flow surrounding holiday trading. The patterns are never exactly 100 percent the same. Exogenous events knock them off kilter, and they change gradually over time with the shifts in human behavior and social traditions.

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